USAID Support for The Free Trade Area of The Americas Initiative (FTAAI)

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Summary

The United States Government has expressed its commitment to an expansion to all countries in the Americas of what is today limited to a free trade agreement (NAFTA) between Canada, Mexico, and the United States. Simultaneously, the U.S. is pursuing trade liberalization through multilateral channels, especially in the context of the World Trade Organization.

This paper reviews the readiness of American countries to join the broader regional trade area, and ways in which the U.S. Agency for International Development (USAID) may support such trade. It argues that the extent to which a country can benefit from an international free trade agreement is directly related to the country's capacity to mobilize and allocate productive resources efficiently. In turn, such capacity is a function of the institutional setting that provides the context for economic transactions and the economics policy regime.

The paper finds that it is of high priority to:

(1) Strengthen market-oriented policies and confidence in underlying institutions. This conclusion is based on the high proportion of countries that received bad scores in the "perception of corruption". It also is consistent with the finding that the detrimental performance of government enterprises is still a key problem for a number of countries.

(2) Further reduce reliance on trade taxes. Countries must develop alternative sources of fiscal revenues as they decrease their reliance on trade taxes. While there has been a big push in the region for tax reform, mainly by broadening or introducing value-added taxes, evasion and exemptions result in low tax yields. Strengthening tax administration would be an important contribution.

The paper also finds that, among USAID-assisted countries, Haiti, Jamaica, Ecuador, and Nicaragua lag behind the other countries in the region in achieving policy reform and institutional development desirable for implementing an extended trade area in the Americas. An important way in which USAID could help is to concentrate efforts in these areas and to enhance the policy-making and implementation capacity of the recipient countries.

Findings from the paper on areas for potential USAID assistance in promoting specific policy reform and institutional development can be summarized in the following table:

	Price Stability	Budget Discipline	Debt-to-Exports	Relative Govt. Cons.	Size of Govt. Enterprises	Price Controls	Interest Rate Controls	Corruption Perception	Political Rights	Trade Taxation
Bolivia					●					
Dominican Rep.					●			●		●
Ecuador	●			●	●			●		
El Salvador								●		●
Guatemala							●	●		●
Haiti	●	●	●			●	●	*	●	●
Jamaica		●			●	●	●	●		●
Nicaragua		●	●		●	●		●		●
Paraguay								●	●	
Peru			●					●	●	

USAID Support for The Free Trade Area of The Americas Initiative (FTAAI)

The United States Government has expressed its commitment to an expansion to all countries in the Americas of what is today limited to a free trade agreement between Canada, Mexico, and the United States (NAFTA). Simultaneously, United States Government policies pursue freer trade also through multilateral channels, especially in the context of the World Trade Organization.

This paper reviews the readiness of American countries to join the broader regional trade area, and ways in which USAID may effectively support such trade area. The approach could well be expanded to assess the readiness of developing countries to join trade liberalization efforts at a multilateral level.

To such end the paper:

- discusses the importance of growth for the U.S. and for other countries in the Americas;
- analyzes country-by-country FTAA-ready indicators;
- examines concrete actions that USAID could undertake to expedite the trade liberalization process.

Promoting Economic Growth and USAID Mandate

That free trade leads to net welfare gains among trading countries is one of the fundamental tenets of modern economics. In general, it is possible to identify two types of gains: static and dynamic.[1]

Static gains are the ones resulting from the application of comparative advantage. By specializing in what countries produce best, and trading, all countries gain. Moreover, as markets broaden, such gains are enhanced by economies of scale in some industries -- average cost of production falls as the volume of production increases.

Dynamic gains result from the stimulus international trade gives to competition. Having to compete in more open markets forces firms to concentrate on becoming more efficient. As long as markets remain open to competition firms cannot afford to become less competitive -- (although some may, and will pay a price). A result is a decrease in anti-competitive practices by domestic firms and fewer resources allocated to rent-seeking activities.

Accordingly, dynamic gains are not once-and-for-all. Moreover, trade involves the transfer of technology (and better management practices) to other countries, making possible continuously

[1] See Council of Economic Advisers, Annual Report, in **Economic Report of the President** February 1998, Chapter 7 on which much of the present and next section are based. Also see Shahid Javed Burki and Guillermo E. Perry, **The Long March A Reform Agenda for Latin America and the Caribbean in the Next Decade**, The World Bank, 1997.

increasing productivity gains. It is from its dynamic effects that trade expansion induces growth: resources are allocated more efficiently, economies of scale are more fully exploited, and the returns to investment are higher.

It is thus no surprise that in low-income developing countries, the importance of more open economies (and hence trade expansion) as a contributor to growth is a matter of empirical record. The experience of the Asian tigers is clear evidence.[2] Chile and El Salvador are two other examples.

In such light, it would seem that USAID would do well in advocating mechanisms that induce freer trade among the countries it offers development assistance. There is, however, the concern of whether the growth record of recent years has been skewed in terms of its income distribution effects.

Does growth benefit only the wealthy? If low-income population groups are not going to benefit much, why would USAID want to use trade as a lever for inducing growth? Such concern should be addressed before moving on.

A key aspect is whether a country enhances its potential to raise the incomes of the poor through economic growth. The issue is rhetorical. Income per capita is an average. Thus, per capita-income indicates the level of income that would be attainable for all members of a society under maximum equality in the distribution of income -- i.e., if all individuals received the same level of income. But, naturally, if a country's per capita income (or GDP per capita) were very low, total equality in the distribution of incomes would just mean that all the members of the society are poor.

The above reasoning underscores the importance of economic growth as a pre-requisite to enhance a country's potential to improve the incomes of its poor. Yet there is still the question of whether growth would just mean that the well-to-do become wealthier with no significant impact on the incomes of the poor.

Preoccupation that economic growth has not tended to help the poor has run parallel with yet another concern: that the process of structural reforms needed to raise the potential for economic growth in itself hurts the poor, at least for the short-to-medium term. Given this perspective, it is perhaps not surprising that one finds occasional skepticism regarding the effectiveness of economic growth to alleviate poverty. Naturally, this also questions the validity of structural and growth-enhancing economic policy reforms. Instead, some of the skeptics have favored interventions that directly transfer resources to the poor.

However, a copious amount of empirically based analysis during recent years does not support the above concern. The analyses resulting from these efforts have been able to exploit new and better databases. The results have been encouraging:[3]

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[2] Present difficulties with the ongoing Asian crisis notwithstanding. The point is that countries whose policies did not penalize exporters have done relatively well; the countries that came closer to adopting freer trade policies (Hong Kong and Singapore, for example) have done even much better. See Jeffrey Sachs and Andrew Warner, "Economic Reform and the Process of Global Integration." *Brookings Papers on Economic Activity*, vol. 1, 1995.

[3] See, for example, Michael Roemer and Mary Kay Gugerty, **Does Economic Growth Reduce Poverty?** CAER II Discussion Papers No. 4 and 5, April 1997.

- Economic growth is essential for improving the lot of the poor.
- In many cases, economic growth has, in practice, been accompanied by rising incomes among the poor.
- Countries that have carried out deep and sustained economic reform efforts have tended to grow faster.
- Development assistance given to reforming countries, or to effectively encourage reforms, influences economic growth rates and the state of the poor.[4]

What this boils down to is that, if providing support to the FTAAI, USAID helps foster trade, growth, and improve the lot of a wide range of income groups in prospective FTAAI countries, including the poor, USAID would be acting within its mandate to promote development and help the world's poor.

What about the impact on the U.S. economy?

Let's take NAFTA. In December 1994 Mexico experienced a deep economic and financial crisis. Output fell, unemployment increased, and real wages fell in Mexico. One of the policy reactions by the Government of Mexico was to raise tariffs barriers against non-NAFTA trade partners.

Because of NAFTA, Mexico did not raise tariff barriers against the U.S. (or Canada). One consequence was that U.S. exports to Mexico did not fall as much as they would have fallen had it not been for NAFTA. A report for the U.S. Government estimated that in 1996 NAFTA increased U.S. income by $13 billion.[5] Moreover, such reports understate the benefits from trade because they only measure static gains. In addition, studies examining the effect of trade on growth, holding other variables constant, indicate that increased openness is associated with higher income.

But as happened with the developing countries, there are concerns in the U.S. that more trade opening would have adverse distributional impacts on Americans. The fear is that trade opening would mean that greater competition with countries with abundant labor resources would translate into lower wages and fewer employment opportunities for U.S. unskilled workers.

Real wages per hour for U.S. production and non-supervisory workers fell between 1973 and 1997, a period when trade grew dramatically, by some 11 percent. While this "fall" surely is affected by Consumer Price Index distortions, such fall has suggested the possibility that falling real wages may be a result of increased trade openness. Total compensation (wage plus nonwage benefits) increased

[4] See Craig Burnside and David Dollar, **Aid, the Incentive Regime, and Poverty Reduction**, World Bank Research Paper no. 1937, June 1998.

[5] Mentioned in The Economic Report of the President 1998, page 238.

during the period, however, although at a lower rate than prior to 1973. So, one could argue that U.S. workers have opted to receive a larger share of their compensation in the form of nonwage benefits.

The slower growth in total compensation is better explained by a slowdown in productivity growth. As measured by output per worker in the nonfarm business sector, productivity grew at 2.9 percent per year between 1959 and 1973, but only at 1.0 percent per year between 1973 and 1990. And it is productivity that established economic theory highlights as a determinant of wages.

A further point is that export industries tend to be high-wage industries. This is the case even after adjusting for skills,[6] and unskilled workers seem to benefit relatively more than skilled workers from working in export industries.

In addition, the near consensus among economists is that trade accounts for only a small proportion of the widening wage-differentials between skilled and unskilled workers. The main factor is the skill-biased technological change that has been occurring in the last 20 years.

There is the issue of whether trade destroys jobs mainly in the U.S. There appears to be a small net gain in jobs but, in fact, what trade does is to shift productive resources (and jobs) to industries where their relative productivity is higher. Some industries lose jobs, others gain. What this means is that workers tend to shift to where they are most productive and earn higher wages. In this light, trade serves to improve the quality of jobs.

The concern that low-wage countries will have an overall advantage over the U.S. is misplaced. Differences in real wages across countries reflect differences in productivity. This is why many foreign firms establish affiliates in the U.S. Nor is the related concern, that U.S. firms that invest overseas are exporting jobs, is in general borne out by the facts. The empirical record shows that increases in employment tend to take place in both the parent firm and the affiliates.

How can USAID help?

If both the U.S. and the other countries in the Americas would gain from freer trade in the region because of the static and dynamic advantages mentioned above, it follows that any USAID action that facilitates such trade would be welfare enhancing.[7] In other words, it would promote the prosperity of the member nations. Thus, improving the enabling environment for trade and growth is one of the most important lines of actions that USAID could adopt.

[6] That is, on average, skilled workers get higher wages in export than in other industries. Likewise, unskilled workers also tend to earn higher wages in export industries.

[7] In a context where global trade is becoming freer and members of a broadening trade pact are bringing down trade barriers vis-à-vis nonmember countries, trade creation is likely to more than offset trade diversion, and the beneficial dynamic effects of freer trade are likely to be very strong.

The relevance is that to the extent that the economic environment in each country[8] is favorable to the use of productive resources in the most efficient way possible (i.e., according to comparative advantage), the potential for trade is expanded. Therefore, USAID can help by assisting aid-recipient countries in the Americas better their economic environment through the promotion of better policies and institutions. (More on USAID-supported policies in a later section.)

"NAFTA Readiness" Indicators

Such indicators are proxies for how are given countries to be able to fruitfully join a trade agreement. The assumption is that the benefits involved from such agreements are directly related to a country's ability to mobilize resources and allocate them efficiently. As free-trade-area agreements cover a broad range of investment, trade, and commercial policies, the Readiness Indicators relate to many different policy areas.

Clearly, this is a mainstream economics concept that can be linked to the idea of economic freedom. As USAID's Mike Crosswell pointed out,[9] economic freedom relates to the enabling environment for markets and private enterprise. It represents freedom from "undue" restraints and controls on the economic activities of individuals and private firms.

There are several institutions that elaborate indexes of "economic freedom". While the specific factors across indexes differ, the factors are similar in that they relate to policies or legal norms such as: monetary policy and inflation, trade policies, tax policies, property rights and their enforcement, regulations, etc.[10]

Applying an index approach, Hufbauer and Schott (hereafter H&S), used seven indicators to measure the degree of readiness of other countries in the Americas to participate in NAFTA-like agreements with the U.S.[11] The relevance of their approach is that it may be used to further explore potential foci for USAID actions in support of trade agreements. What follows builds on, and revises, H&S's work. The indicators presented below roughly follow the same order as that used by H&S.

Readiness Indicator 1: Price Level Stability

[8] By economic environment this paper is going to refer to policies and institutions that govern and influence economic activities.

[9] The comments in this and the next paragraph borrow from Michael Crosswell, Background Note: Economic Freedom, Economic Growth, U.S. Exports, and USAID (October 1996).

[10] A forthcoming paper by USAID's Office of Emerging Markets will present the policy conditions and competitiveness conditions measured by these "Policy Indicators".

[11] Gary Clyde Hufbauer and Jeffrey J. Schott assisted by Diana Clark, **Western Hemisphere Economic Integration**, Institute for International Economics (July 1994).

One reason why price level stability (low inflation) is prized is for its ability to shield economies from enormous shifts in the real exchange rate when nominal rates are steady. Unless they are matched by nominal exchange rate adjustments of comparable magnitude, when such shifts occur, the traded goods sector is exposed to wild swings in fortunes which tend to foster anti-trade sentiments in both the trading partner and in the domestic country.

The scoring system used three-year average annual rates of inflation (the simple arithmetic average) for 1990 to 1992, covering twenty-five countries in the Western Hemisphere.[12] (Scores for the United States and Canada were also provided.) Inflation rates between zero and five percent (on average) earned top marks of 5 points; between five and twenty percent earned 4 points; between twenty and fifty percent earned 3 points; between fifty and one hundred percent earned 2 points; and between one hundred and two hundred earned 1 point. Inflation rates higher than an average of two hundred percent earned zero points on this readiness indicator.

During the reference (benchmark) period for 1990 to 1992, Argentina, Brazil, Nicaragua, and Peru fell into the zero points group. Only Panama earned top marks at 5 points.[13]

In table 1, the USAID countries from the Western Hemisphere are shown with their price stability indicator score from 1990-92, an updated score for 1995-97, and the change in score. The data for 1990-92 are taken from H&S, while the data for 1995-97 are from the 1998 edition of the USAID data book on Latin America and the Caribbean. (Data from this book rely on estimates provided by the respective USAID Missions.)

Of the fourteen USAID countries in the LAC region, only one country - Haiti - has had its readiness indicator for price stability decline since 1992. Four countries are unchanged on this measure, with the remaining nine countries posting higher scores. Two of those nine - Nicaragua and Peru - improved their scores from zero to 4 points. Another country - Brazil - improved its score from 0 to 3 points.

As it stands for 1995-97, every country is at 3 points or higher on price stability - the mark at which Mexico stood when it joined NAFTA. Chile, it should be noted, has advanced its score up one notch from 3 to 4 points.

These scores may be interpreted as indicating that, according to price stability, no country should necessarily be excluded from consideration for inclusion in a free trade area. Nonetheless, one could point out that, among the USAID-served countries, especially Haiti (which experiences a decrease in its score), but also Ecuador, deserve carefully monitoring regarding inflation. In the larger region, other countries of concern would be Brazil and Mexico.

[12] Unless otherwise indicated, references to “the scoring system” relate to the methodology used by Hufbauer and Schott.

[13] It is interesting to note that, back in 1994, both Mexico and Chile were considered "ready" as investment and trade agreement partners, but both countries only picked up 3 points on this measure.

Table 1
Price Level Stability

	Inflation Rate	Readiness Score	Inflation Rate	Readiness Score*	Change in Readiness Score
	1990-92		1995-1997		
Bolivia	17	4	9	4	Unch.
Brazil	1,460	0	37	3	Up 3
Dominican Rep.	39	3	7	4	Up 1
Ecuador	51	2	26	3	Up 1
El Salvador	16	4	8	4	Unch.
Guatemala	28	3	10	4	Up 1
Guyana	57	2[14]	8	4	Up 2
Haiti	19	4	23	3	Down 1
Jamaica	50	2	19	4	Up 2
Mexico	22	3	30	3	Unch.
Nicaragua	3,416	0	11	4	Up 4
Panama	1	5	1	5	Unch.
Paraguay	26	3	10	4	Up 1
Peru	2,655	0	10	4	Up 4
Addenda					
Chile	21	3	7	4	up 1
United States	4	5	3	5	unch.

Sources: See text.
* An up movement means an improvement.

Readiness Indicator 2: Budget Discipline

Budget discipline is desired for several reasons. First, budget deficits tend to be inflationary since they put central banks under pressure to expand the monetary base to finance them. Second, if funded by selling interest-paying debt at home and/or abroad, current fiscal deficits mortgage future budgets to interest payments and debt service. Third, debt financing might result in higher interest rates that discourage domestic investors and thus limit growth.

Fourth, budget deficits tend to enlarge the balance-of-payments (bop) deficit on current account, and to eventually raise the level of external indebtedness. Finally, as highlighted by H&S, a real danger with chronic current account (bop) deficits is that governments will come under pressure to impede the free flow of imports and capital.[15]

[14] In the 1994 book, H&S awarded 3 points on price stability to both Guyana and Jamaica, even though both average inflation rates were in excess of fifty percent and thus - by their stated criteria - should have earned only 2 points. The table in this update uses a score of 2 points for consistency.

[15] H&S looked for a statistical correlation between fiscal and balance of payments (bop) current account deficits in Latin America for the 1981 to 1992 period. Among smaller economies in the region, the correlation was significant (yet the R^2 was only 0.27), but they found no correlation between these deficits for the large Latin American countries (Mexico, Brazil, Chile, Argentina, Colombia, and Venezuela). H&S attribute this lack of correlation to the fact that smaller

H&S' scoring system used consolidated budget balances of the central government as a percentage of GDP, measured by a three-year average for 1990-92. Their data covered twenty-five countries in the Western Hemisphere. (Scores for the United States and Canada were also provided.) Deficits less than 2.5 percent of GDP earned 5 points, as did a fiscal surplus; between 2.5 and 4.0 percent earned 4 points; between 4.0 and 6.0 percent earned 3 points; between 6.0 and 8.0 percent earned 2 points; and between 8.0 and 10.0 percent earned 1 point. Fiscal deficits higher than 10.0 percent of GDP earned zero points on this readiness indicator.

During the reference period for 1990 to 1992, Brazil, Guyana, and Surinam fell into the zero points group. Fully fifteen of the twenty-five countries earned the highest marks of 5 points during this period. Indeed, even the United States could not match that performance, earning only 3 points. Mexico and Chile had both run a series of budget surpluses and collected 5 points each. For the practical purposes of readiness, however, 3 points seem more than sufficient, given that the United States (and Canada, as well) had only 3 points and were considered ready for NAFTA.

Table 2 shows fiscal deficit indicator scores from 1990-92 and updated scores for 1995-97. The data for 1990-92 are taken from H&S, while the data for 1995-97 are from the 1998 edition of the LAC data book on Latin America an the Caribbean. (Data from this book rely on estimates provided by the respective USAID Missions.) The U.S. update is taken from the 1999 *Economic Report of the President*.[16] (Because of a lack of new data, the updated score for Chile is based upon 1994-96.) Nearly all of the countries showed no change in their readiness score on the fiscal balance indicator - - most were at the highest score and stayed there. Even the United States boosted its standing from 3 to 5 points. Haiti, however, posted a notable downturn, sliding 3 points, while Jamaica and Nicaragua also slipped. One should note that all three are countries with USAID missions. In contrast to these countries, Brazil posted a strong gain of three points.

It thus follows that, USAID would help promote the preconditions for joining a trade area of the Americas by encouraging budget-discipline, and helping strengthen the institutions needed to achieve it, in Haiti, Jamaica, and Nicaragua.

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economies in the region have traditionally had fewer capital controls than the larger economies have had - - which would allow the fiscal-current account linkages to operate. An alternative explanation could be that, other things equal, the smaller the economy the more dependent on trade it tends to be. Accordingly, in smaller economies fiscal deficits are more readily reflected on the current account of the international balance of payments. (The United States is probably a good example of the lack of correlation in a big economy.)

[16] As with most of the readiness indicators, H&S worked with the estimates available *at the time* they were writing. Slight revisions to those estimates have often been made, of course. However, those revisions were not incorporated in the table on the next page.

Table 2
Budget Discipline

	Budget Deficit as % GDP	Readiness Score	Budget Deficit as % GDP	Readiness Score	Change in Readiness Score*
	1990-92		1995-97		
Bolivia	-0.5	5	-2.3	5	unch.
Brazil	-20.2	0	-4.3	3	up 3
Dominican	+1.9	5	-0.6	5	unch.
Ecuador	+1.5	5	-2.2	5	unch.
El Salvador	-2.4	5	-1.8	5	unch.
Guatemala	-0.7	5	0.0	5	unch.
Guyana	-17.2	0	n.a.	n.a.	n.a.
Haiti	-2.4	5	-6.3	2	down 3
Jamaica	+2.9	5	-5.5	3	down 2
Mexico	+1.7	5	-0.3	5	unch.
Nicaragua	-7.7	2	-8.9	1	down 1
Panama	-0.1	5	-0.6	5	unch.
Paraguay	+0.7	5	n.a.	n.a.	n.a.
Peru	-3.1	4	+0.7	5	up 1
Addenda					
Chile	+1.9	5	+1.9	5	unch.
United States	-4.9	3	-1.4	5	up 2

* An increase is an improvement.

Source: The data for 1990-92 are taken from H&S, while the data for 1995-97 are from the 1998 edition of the USAID/LAC data book, using data provided by the respective USAID Missions. The U.S. update is taken from the 1999 *Economic Report of the President*. Because of a lack of new data, the updated score for Chile is based upon 1994-96.

Readiness Indicator 3: Total External Debt-to-Exports Ratio

This ratio may serve as an indicator of whether the exchange rate regime is sustainable and whether a country will be able to meet its external payments obligations. Along those lines, it may signal whether the risk premium attached to investing in a given country is increasing or not.

The scoring system used total external debt (which includes private and public external debt) as a percentage of the exports of goods and services for 1992 or the most recent year available (as of 1994). The *World Debt Tables* of the World Bank were used. Countries whose debt-to-exports ratio was below 150 percent earned top marks of 5 points; ratios between 150 and 220 percent earned 4 points; between 220 and 290 percent earned 3 points; between 290 and 360 earned 2 points; and between 360 and 430 earned 1 point. Debt ratios above 430 percent earned zero points on this Readiness Indicator. H&S applied this Readiness Indicator to twenty-four countries, as well as to the United States and Canada.

With the reference point as 1992, Argentina, Bolivia, Guyana, and Nicaragua fell into the zero points group. Six of the countries: the Bahamas, Barbados, Chile, El Salvador, Paraguay, and Trinidad-

Tobago earned top marks at 5 points. Indeed, many countries do relatively well on this measure. In addition to six countries getting the maximum score, another seven earned 4 out of 5 points and another three earned 3 points. Thus, two-thirds of the countries earned 3 or more points. A score of 3 is apparently enough for readiness, considering that Mexico had only earned 3 points and entered NAFTA, with all of its investment and trade provisions.

Table 3 shows the USAID countries from the Western Hemisphere with their external debt indicator score from 1992, an updated score for 1996, and the change in score. The data for 1992 are taken from H&S, while the data for 1996 are from the 1998 edition of the World Bank's *World Development Indicators*.

Table 3
External Debt-to Exports Ratio

	Debt Ratio	Readiness Score	Debt Ratio	Readiness Score	Change in Readiness Score
	1992		1996		
Bolivia	536	0	270	3	up 3
Brazil	331	2	292	2	Unch.
Dominican Republic	185	4	108	5	up 1
Ecuador	339	2	246	3	up 1
El Salvador	130	5	78	5	Unch.
Guatemala	150	4	102	5	up 1
Guyana	676	0	226	3	up 3
Haiti	187	4	297	2	Down 2
Jamaica	154	4	101	5	up 1
Mexico	243	3	154	4	up 1
Nicaragua	3,466	0	763	0	Unch.
Panama	223	3	69	5	up 2
Paraguay	114	5	47	5	Unch.
Peru	453	0	318	2	up 2
Addenda					
Chile	149	5	166	4	Down 1
United States	98	5	n.a.	n.a.	n.a.

Source: See text.

Of the fourteen USAID countries in the region, only one - Haiti - has had its Readiness Indicator for external debt decline since 1992. Four countries are unchanged on this measure: Nicaragua remains at zero points, Brazil remains at 2 points, while El Salvador and Paraguay remain with top marks of 5 points. Panama is up 2 points, to the maximum score.

As it stands for 1994-96, every country except for Brazil, Haiti, Nicaragua, and Peru is at 3 points or higher on the external debt ratio - the mark at which Mexico stood when it joined NAFTA. Chile, it should be noted, has dropped its score by one mark to 4 points.

In sum, Nicaragua, Haiti, and possibly Peru, are countries that might benefit from a strengthening of their capacity to manage external debt in harmony with their exchange rate, budget, and monetary policies. All three are USAID-assisted countries.

Readiness Indicator 4: Exchange Rate Stability

Exchange rate stability affects trade in goods and services, as well as capital movements. A pattern of instability has an adverse impact on both international trade and capital movements.[17]

For scoring, H&S used the real effective exchange rate indexes (the annual average with the US dollar) for 1990 to 1992, calculating the standard deviation of those three numbers. Standard deviations less than ten earned top marks of 5 points; standard deviations between ten and thirty earned 3 points; and standard deviations greater than thirty earned zero points.

No country fell into the zero points category. Indeed, seventeen of twenty-one Latin American countries earned the top marks of 5 points.

Instead of using the standard deviation as a measure of exchange rate stability, the present paper uses the coefficient of variation (*i.e.*, the standard deviation divided by the mean exchange rate) for such purpose.[18] On the basis of data for the 1990-92 years, the paper first presents the coefficient of variation estimates and provides the new scores for such years. The next step was to estimate changes in "readiness", as measured by the coefficient of variation, for more recent years.

Data for a 1995-97 measure were available for all the countries, but from two different sources, as noted in the footnote to table 4.

Nearly every country had an unchanged score according to exchange rate stability. As was true for the 1990-92 reference period, no country fell into the zero points group and only very few failed to earn top marks for the 1995-97 periods.

These results make one wonder whether this indicator of readiness for inclusion in a free trade area needs some fine tuning to actually sort countries. Besides, it is notable that Mexico -- deemed ready for NAFTA -- was one of the three countries to fail to earn top marks on this score. On the other hand, the indicator may just be signaling that what matters is being within a certain range.

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[17] While H&S highlight these points, it is unclear here whether they are warning against changes in exchange rates *per se* or an up-down cycle of changes. Given the fact that they only use a three-year reference period, many countries experience sustained real currency appreciation or depreciation in so short a time. If the currency started out over- or under-valued, then the exchange rate change would be the vehicle by which a country is made ready to enter into a trade agreement with other countries. For example, if a country's currency is undervalued, other prospective FTA partners will consider that country to be "too" competitive.

[18] The advantage of this alternative procedure is that the coefficient of variation ensures that the measure of stability is independent of the base year used.

Table 4
Exchange Rate Stability: 1990-92 and 1995-97

	Fluctuation of Average REER	Readiness Score	Fluctuation of Average REER	Readiness Score	Change in Readiness Score
	1990-92		1995-97		
Bolivia	2%	5	5%	5	unch.
Brazil	16%	3	3%	5	up 2
Dominican Rep.	4%	5	3%	5	unch.
Ecuador	3%	5	4%	5	unch.
El Salvador	2%	5	4%	5	unch.
Guatemala	12%	3	8%	5	up 2
Guyana	7%	5	7%	5	unch.
Haiti	15%	3	21%	3	unch.
Jamaica	12%	3	30%	3	unch.
Mexico	8%	5	12%	3	down 2
Nicaragua	8%	5	1%	5	unch.
Paraguay	8%	5	4%	5	unch.
Peru	13%	3	2%	5	up 2
Addenda					
Chile	4%	5	7%	5	unch.
United States	3%	5	7%	5	unch.

Note: The "fluctuation in average REER" is defined as the standard deviation divided by the mean of the annual average value of the real effective exchange rate index.
Source: For about half the countries (Bolivia, the Dominican Republic, Ecuador, Guyana, Nicaragua, Paraguay, Chile, and the United States), the source is the IMF's *International Financial Statistics*. For the rest of the countries (Brazil, El Salvador, Guatemala, Haiti, Jamaica, Mexico, and Peru), the source is the IDB's Economic and Social Data Base, located at http://www.iadb.org/int/sta/ENGLISH/staweb/dbase_esdb_frame.htm.

Readiness Indicator 5: Market-Oriented Policies, Privatization and Deregulation

The fifth indicator for readiness to participate in a NAFTA-style investment and trade accord is market-oriented policies, primarily privatization and deregulation of industry. Investment agreements such as NAFTA, after all, are basically about establishing a liberalized environment for private investment.

In terms of the actual details of agreements such as NAFTA, two points bear highlighting: (1) NAFTA locked in zero tariff rates, an important accomplishment; nonetheless, (2) investment deregulation and rights given to private corporations take up the lion's share of the accord. It would seem that, if H&S were to nominate a single readiness indicator for NAFTA-style agreements, it would probably relate to privatization and deregulation.

However, it was not possible to replicate H&S' methods.[19] Instead, the paper relies on different dimensions of "Economic Freedom" to establish readiness on the basis of the enabling economic environment.

Economic Freedom is a general concept used to measure the existence of legal, financial, and business practices which promote the enforcement of property rights and the freedom to engage in market transactions without excessive government control or interference. Writing recently for the Cato Institute, Steve Hanke pointed out that although scholars and practitioners have yet to agree on a single, operational definition of economic freedom, there appeared to be an emerging consensus about the elements it covered.[20]

There are currently three separate organizations that measure Economic Freedom, each using a similar, though slightly different, methodology. The indicators below are six used by the Fraser Institute of Canada to evaluate concepts relating to the size and role of the government in the economy, out of 25 indicators used to measure various aspects of Economic Freedom:

- *I-A Government general consumption as a share of GDP*. The rationale is that increases of government consumption relative to GDP indicate that political decision-making is substituted for market choices and coordination.[21]

- *I-B Transfers and subsidies as a share of GDP*. The rationale is that excessive transfers and subsidies controlled by the government distort efficient allocation pricing by the market, and hinder competition.

- *II-A Government-operated enterprises as a share of the economy*. The rationale is that government-operated enterprises use start-up capital obtained from taxpayers and that, as a rule, investment decisions in public sector firms are often made by political appointees (which makes them more vulnerable to political pressure). Moreover, subsidies, favorable tax treatment and regulations are often used to protect state-operated firms from private competitors.

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[19] As H&S explain, the scores on this measure are much more judgmental and qualitative. H&S gave Canada and the United States a top score of 5 points, as a sort of benchmark. For the rest of the Latin American countries, the score of market-oriented policies is the simple average of three judgmental scores on privatization, deregulation, and tariff reduction. The data sources were the *Financial Times* and the *Journal of Commerce* for privatization; two books from the Institute of International Economics (1990 and 1994) by Williamson for deregulation; and the Annual Report on Trade Policies from the U.S. Office of the Trade Representative, as well as reports from CEPAL, the Inter-American Development Bank, and the U.S. International Trade Commission. Unfortunately, H&S did not publish their three component scores from which the average mark was calculated.
For the privatization component of the market-oriented policy indicator score, H&S stated that countries with operational privatization programs got the best marks, announced programs not yet implemented got middling marks, and no plans at all got low marks.
The component scores, however, remained unpublished. That made it impossible to update H&S tables.

[20] Hanke, Steve and Stephen J.K. Walters. "Economic Freedom, Prosperity, and Equality: A Survey." The Cato Journal. Volume 17, Number 2. This article is accessible at www.cato.org/pubs/journal/cj17n2-1.html.

[21] See James Gwartney, Robert Lawson, and Walter Block, **Economic Freedom of the World:1975-1995** (Fraser Institute, 1996).

- *II-B Price controls*. The rationale is that such controls distort the free allocation of resources among individuals.

- *V-C Equality of citizens under the law and access to nondiscriminatory judiciary*. The rationale is that a legal structure that clearly defines property rights, enforces contracts, and provides a mutually agreeable mechanism for dispute resolution is essential for a market economy.

- *VII-C Interest rate controls and regulations that lead to negative real interest rates.* The rationale is that when inflation exceeds interest rates, there is little incentive to save using official financial system institutions. This condition often exists when government regulations and controls restrict financial institutions from offering market-determined interest rates.

Table 5a shows the Fraser Institute's scores for the first three. Let's go over each of them.

Scores on (relative) *government consumption* were calculated by the FI by translating general consumption expenditures as a percent of GDP[22]to ratings ranging from zero (meaning a share of government consumption approximately higher than 23 percent) to ten (a share of government consumption under, approximately, 8 percent). Accordingly, the higher the rating the lower the share of government consumption and, by the rationale indicated above, the lower the degree of substitution of political decision-making for market-determined results.

The present paper takes as significant only changes equal or greater than 10 percent in the score for 1997 relative to 1990. Using this criterion one has that only one country, Nicaragua, experienced significant change, and it was for the better. For the other countries with data for the two years, the country which experienced a score deterioration closest to being significant was Ecuador - - a change of 9 percent. (That means that the government's share in consumption rose during the period leading to a fall in the score by 9 percent.) Brazil and the Dominican Republic were next with score falls of 8 and 7 percent, respectively. Moreover, the lowest scores in 1997 (Brazil and Panama) are slightly below 7.0 and thus well on the upper side of the score distribution range.

The results for relative government consumption suggest that, as an indicator of market distortion, government consumption is not a priority for donor institution attention.

The next indicator for market-oriented policies in the table, size of government enterprises, measures the significance government enterprises play in the economy. A high rating indicates that government enterprises play a less significant role. Rating scores range from ten to zero. Ten means that there are few government operated enterprises, and the estimates are that they produce less than 1 percent of the country's total output. A score of zero reflects an economy dominated by government-operated enterprises with employment and output in such enterprises generally exceeding 30 percent of the total non-agricultural employment and output.

[22] Or, in some cases, as a percent of total consumption.

Table 5a
Economic Freedom
Size and Role of Government Operations

	Government Consumption		Government Enterprises		Transfers and Subsidies	
	1990	1997	1990	1997	1990	1997
Bolivia	8.3	8.3	2	2	9.4	9.5
Brazil	7.4	6.8	6	6	7.2	6.1
Dominican Republic	10.0	9.3	4	4	9.7	9.7
Ecuador	9.1	8.3	4	4	9.5	9.7
El Salvador	9.1	9.3	8	8	9.8	9.3
Guatemala	9.8	10.0	8	8	9.6	10.0
Haiti	9.6	N/A	6	N/A	N/A	N/A
Jamaica	8.1	7.8	4	4	9.6	9.1
Mexico	9.3	8.8	4	6	9.4	8.6
Nicaragua	5.0	8.5	0	0	8.3	8.5
Panama	7.1	6.8	6	6	8.1	8.3
Paraguay	9.8	9.6	7	7	9.6	9.3
Peru	9.8	9.3	6	8	9.3	9.4
Addendum						
Chile	8.7	8.8	6	7	7.3	7.2
United States	7.4	7.3	8	8	6.7	6.3

Source: Fraser Institute.

The table shows that, by far, most countries experienced no change in their rating scores. The countries that did experience significant changes in scores (i.e., changes of more than 10 percent), Mexico, Peru, and Chile, indicate a decrease in the importance of government enterprises in the economy. So, to the extent that there was change, it was change for the better.

On the other hand, the scores do suggest the existence of substantial margins for decreasing the role of government enterprises in particular countries. In effect, five countries show scores of four or less - - Bolivia, Dominican Republic, Ecuador, Jamaica, and Nicaragua. And, as per the FI methodology, a score of four means that the number of government-operated enterprises in many sectors of the economy, including manufacturing, is substantial. The worst situation is in Nicaragua. There, a score of zero suggests domination by government-operated enterprises.

One should underline that the five countries are USAID-assisted countries. This seems a clear signal that, at least in such countries, through its privatization programs, USAID could contribute to greater trade-integration-readiness.[23]

The last indicator of trade-readiness in table 5a relates to the weight of government transfers and subsidies in the economy. Higher scores indicate less weight. On the rationale that the greater the

[23] One should note that, as with level of government consumption, data for Haiti are not available for 1997.

weight of such transfers and subsidies, the lesser the scope for market competition, and using the 10 percent change-in-score criterion as the threshold for significance, only Brazil experienced significant deterioration.[24]

Moreover, with the exception of Haiti for which data was not available, all countries have a score rating of 6.1 (Brazil) or higher. Since the United States' score was not much higher than Brazil's, as one could consider the United States' economy as a benchmark, and since all other countries had a significantly higher score than the United States, it would seem that the magnitude of overall transfers and subsidies does not call for priority attention by USAID at this point.[25]

Table 5b presents scores for two of the three other indicators of economic freedom mentioned initially: price and interest rate controls. Once again, the higher the score the better the country's situation. As pointed out previously, the FI institute scores countries also on "equality of citizens under the law and access to nondiscriminatory judiciary" as a measure of how adequately the legal structure meets the requirements of a market economy. Unfortunately, results published for 1990 and 1997, and across countries, seem not comparable.[26] For such reason, this paper used indicators from other sources instead (read on).

The scores relating to price controls (table 5b) show significant improvement between 1990 and 1997 for all countries except Haiti and Jamaica. No deterioration (i.e., increase) in price controls for any country.

The score for Haiti suggests that there still were, in 1997, price controls of significance applying to products in agriculture and manufacturing. The scores for Jamaica, Nicaragua, and Panama imply that, while most prices are set by market forces, there are controls on energy and some agricultural and other products widely purchased by households (e.g., food products and house rents). Among the USAID countries, a big improvement, relative to 1990, is noticeable especially for Nicaragua.

Summing up, Haiti, Jamaica, Nicaragua, and Panama are the countries where USAID attention is needed in the assessment of price controls.

The final variable on table 5b is interest rate controls. Once again, the table shows significant improvement during 1990-1997 with deterioration (i.e., increase in controls) only in Guatemala and in Jamaica. The table suggests that, of the USAID-supported countries, those two countries, plus especially Haiti, would still benefit from Agency support to further reforms toward diminishing interest rate control distortions.

[24] The other country which came close to a significant score deterioration was Mexico which experienced a negative change in score of 9 percent.

[25] This point is debatable. What may be warranted in a wealthy and dynamic economy as the United States' may not be necessarily affordable in much poorer economies. However, the examination of this issue, which requires an in-depth analysis of how and to whom transfers are made in the countries, is beyond the scope of the present paper.

[26] This may reflect a misunderstanding of this index, typographical errors, or methodological problems.

Table 5b
Economic Freedom
Size and Role of Government Operations, continued

	Price Controls		Interest Rate Controls	
	1990	1997	1990	1997
Bolivia	6	9	8	8
Brazil	0	8	0	8
Dominican Republic	4	6	0	8
Ecuador	0	6	0	8
El Salvador	4	8	8	10
Guatemala	6	8	8	6
Haiti	2	2	0	4
Jamaica	4	4	8	6
Mexico	0	7	8	6
Nicaragua	0	4	0	8
Panama	2	4	10	10
Paraguay	4	6	2	8
Peru	2	8	0	8
Addendum				
Chile	8	9	8	10
United States	8	9	10	10

Source: Fraser Institute.

The next two indicators, the index of corruption perception (table 5c) and the index of political rights (table 5d) are the ones used as proxies for contract enforcement, property rights, and adequate mechanisms for dispute resolution. These indices are, respectively, from Transparency International and Freedom House. While the corruption index follows the same pattern as those of the Fraser Institute in the sense that a higher index indicates a better situation, the political rights index is just the reverse, the lower the better.

The corruption index in table 5c allows only for a very limited comparison of the situation in 1998 relative to earlier years (1988-1992 period). The comparison with those earlier years can be made only for two USAID-assisted countries. In one of them, Bolivia, the perception of corruption improved during the 1990s. In the other, Ecuador, the situation deteriorated.

However, using Chile as a benchmark one can see that in 1998 there was ample room for improvement. The worst case is Paraguay, followed by Ecuador and Bolivia. But even in the rest of the countries, El Salvador, Guatemala, Jamaica, Nicaragua, and Peru the perception of corruption is significantly greater than in Chile. This implies that USAID assistance to enhance the transparency and effectiveness of public sector operations in such countries has the potential of leading to more efficient allocation of resources, more equitable conditions, and higher economic growth.

Table 5c
Corruption Perception Index

	1998	1988-92
Bolivia	2.8	1.3
Brazil	4.0	3.5
Ecuador	2.3	3.3
El Salvador	3.6	n/a
Guatemala	3.1	n/a
Jamaica	3.8	n/a
Mexico	3.3	2.2
Nicaragua	3.0	n/a
Paraguay	1.5	n/a
Peru	4.5	n/a
Addendum		
Chile	6.8	5.5
United States	7.5	7.8

Source: Transparency International.
Data not available for Dominican Republic, Haiti, or Panama.

Table 5d
Political Rights Index

Country	1990-91	1997-98
Bolivia	2.0	1.0
Brazil	2.0	3.0
Dominican Republic	2.0	2.5
Ecuador	2.0	2.5
El Salvador	3.0	2.0
Guatemala	3.0	3.0
Haiti	5.5	4.0
Honduras	2.0	2.0
Jamaica	2.0	2.0
Mexico	4.0	3.0
Nicaragua	3.0	2.5
Panama	4.0	2.0
Paraguay	3.5	4.0
Peru	3.0	5.0
Addendum		
Chile	2.0	2.5
United States	1.0	1.0

Source: Freedom House.
Rated from 1 (Best) to 7 (Worst).

The results of the Political Rights index on Table 5d are roughly consistent with the above conclusions. In terms of political rights, from 1990-1991 to 1997-1998, the situation deteriorated in five USAID-assisted countries and improved in four of them with no change in two. For 1997-1998 political rights problems were most acute in Peru, Haiti, and Paraguay. In line with the recommendation made in the previous paragraph, continuous support for strengthening democratic infrastructure in the region is a contribution toward securing sustainable long-term growth.

Readiness Indicator 6: Reliance on Trade Taxation

The sixth indicator for readiness to participate in a NAFTA-style investment and trade accord consisted in reliance on trade taxes. In a NAFTA-style arrangement, tariffs and export taxes are typically eliminated or sharply lowered. Accordingly, it is important that the revenue impact not disrupt macroeconomic stability.

Many governments have traditionally relied upon trade taxes for significant shares of their total revenue, at least in part because those duties are less easily evaded. H&S indicate that when trade taxation exceeds some fifteen percent of the total government revenue, an investment and trade program like NAFTA can be very disruptive.

The scoring system used three-year average percent share of current revenues that trade taxes represented for 1989 to 1991. Data in the H&S book covered twenty-four countries in the Western Hemisphere. (Scores for the United States and Canada were also provided.) International trade taxes as a percentage of current revenues less than five percent earned top marks of 5 points; between five and ten percent earned 4 points; between ten and fifteen earned 3 points; between fifteen and twenty earned 2 points, and between twenty and twenty-five earned 1 point. Any countries for which trade taxes accounted for more than twenty-five percent of current revenues were given zero points.

During the reference period for 1989 to 1991, Costa Rica, Guatemala, Honduras, the Bahamas, and the Dominican Republic all earned zero points. Indeed, the Bahamas netted sixty percent of its current revenues from trade taxes. Only Brazil earned top marks of 5 points, with an average reliance on trade taxes of two percent. Even a score of 4 points seemed hard to attain, as only Chile, Bolivia, Venezuela, and Trinidad-Tobago earned that second-place mark.

In Table 6, the USAID countries from the Western Hemisphere are shown with their reliance on trade taxes indicator score from 1989-91. There are two ways in which the scores have been updated. An average percent share for the 1991-95 period is presented with the source being the 1996 IDB report *Economic and Social Progress in Latin America*. Brazil, however, is based on 1990-92 and is taken from the 1997 World Bank *World Development Indicators*. Although a five-year average reference period may obscure any late-breaking trends, the only way that the IDB and World Bank published these numbers was as a five-year average.

Using a five-year reference period, the reliance on trade taxes appears to have worsened for five of the fifteen Latin American countries. In only three countries did the scores increase. About half the countries posted no change in their score. However, comparing just 1995 to the earliest period tells a different story. For those eleven countries, five improved their score while only one country posted a lower score.

Probably of greater interest however is focusing on countries for which trade taxes accounted for more than 15 percent of revenues. Such countries were Dominican Republic, El Salvador, Guatemala, Haiti, Jamaica, and Nicaragua.[27] The implication is that USAID should consider allocating resources to help such countries diversify their sources of tax revenues.

[27] Had the 1991-1995 period been taken as reference, the number of countries would have jumped to nine. Accordingly, the text makes a conservative estimate of the number of countries likely to face public revenue difficulties if joining a trade pact.

Table 6
Reliance on Trade Taxes

	Reliance on Trade Taxes			Readiness Score			Change from 1989-91 to 1995
	1989-91	1991-95	1995	1989-91	1991-95	1995	
Bolivia	7%	10%	7%	4	3	4	Unchanged
Brazil	2%	2%	2%	5	5	5	Unchanged
Dominican Republic	34%	35%	37%	0	0	0	Unchanged
Ecuador	14%	24%	11%	3	1	3	Unchanged
El Salvador	20%	19%	17%	2	2	3	Up 1
Guatemala	28%	42%	23%	0	0	1	Up 1
Guyana	13%	13%	10%	3	3	4	Up 1
Haiti	20%	18%		1	2		
Jamaica	20%	21%		2	1		
Mexico	13%	9%	4%	3	4	5	Up 2
Nicaragua	14%	13%	21%	3	3	1	Down 2
Panama	13%	24%	11%	3	1	3	Unchanged
Paraguay	17%	20%	12%	2	2	3	Up 1
Peru	15%	15%	10%	2	3	4	Up 2
Addenda							
Chile	8%	13%	9%	4	3	4	Unchanged
United States	2%	2%	1%	5	5	5	Unchanged

Source: See text. 1995 data are from the World Development Indicators, Table 4.14.

Implications for USAID Action

As explained earlier in the paper, its focus has been on replicating and updating the work by Hufbauer and Schott on readiness for economic integration in the Western Hemisphere. A consequence of that limited focus is that the paper has not attempted to look at all potential policy and institutional reform interventions. Nonetheless, what follows ties up the results of the review with implications for also other areas not mentioned before.

Table 7 presents a snapshot of readiness-indicator areas reviewed where USAID-supported countries in Latin America and The Caribbean exhibit weaknesses. It has been argued that such areas merit donor attention. The cells marked with an "•" represent a country and area for potential assistance.[28]

[28] Exchange rate stability and government transfers and subsidies were not included in the table as these indicators did not suggest fundamental problems.

Table 7
Areas for Potential USAID Intervention

	Price Stability	Budget Discipline	Debt-to-Exports	Relative Govt. Cons.	Size of Govt. Enterprises	Price Controls	Interest Rate Controls	Corruption Perception	Political Rights	Trade Taxation
Bolivia					●					
Dominican Rep					●			*		●
Ecuador	●			●	●			●		
El Salvador								●		●
Guatemala							●	●		●
Haiti	●	●	●			●	●	*	●	●
Jamaica		●			●	●	●	●		●
Nicaragua		●	●		●	●		●		●
Paraguay								●	●	
Peru			●					●	●	

An "*" relates to countries for which data were not available but in which, nonetheless, the authors sense a problem on the basis of casual observation and knowledge of the country.

The table makes it apparent that the areas where the set of countries examined exhibited the greatest weaknesses are in:

- Strengthening market-oriented policies and confidence on underlying institutions. This conclusion is based on the high proportion of countries that received bad scores in the "perception of corruption". It also is consistent with the weight of government enterprises still emerging as a key problem for a number of countries.

The policy implication for USAID is that is should devote resources to improving the legal and regulatory environment needed in market-led economies. Such environment has to do with: effective respect of property rights and contract enforcement; regulations that decrease the transaction costs of doing business; an independent judiciary that is perceived as effective, independent, and fair; and a public administration perceived as professional, ruled by laws and dedicated to the public interest. One knows that when these conditions are not significantly met (1) economic agents will engage in rent-seeking rather than in productive activities, (2) investors will operate with a short-term horizon and opt for quick pay-back investments, and (3) low-income population groups will tend to feel abandoned and alienated from the social system. In such context the efficient allocation of productive resources, and the potential for growth, are adversely affected.

While not directly addressed in this paper, helping to improve the efficiency of financial systems is also important in this connection. Savers should be rewarded for postponing consumption, and savings allocated to high productivity endeavors (rather than to persons with the "right" connections). Achieving that would go a long way in restoring confidence in the social and economic system. After all, people with ideas for business initiatives should see the financial sector as a potential source of assistance.

Another implication for USAID is increasing the scope of its efforts to assist in privatization processes. As advanced in the text, the greater the weight of these enterprises in an economy, the broader the scope for decision made on the basis of non-market criteria. Which increases the chances for bribes and influence peddling.

Likewise, the table reveals that price and interest rate controls are still of importance in several countries. In fact, when one thinks about it, that corruption, controls, and government enterprises came out as areas deserving USAID attention probably reflects the same thing: USAID could help through its support to fostering an enabling environment for trade and economic growth.

- Further reducing reliance on trade taxes emerges as another important area for USAID interventions. The issue is that countries must develop alternative sources of fiscal revenues as they decrease their reliance on trade taxes. While there has been a big push in the region for tax reform, mainly by broadening or introducing value-added taxes, evasion and exemptions result in low tax yields.[29] Institution building by helping strengthen tax administration would be an important contribution.

- The indicators of Table's 7 first four columns relate to macroeconomic conditions. It would seem that attention to strengthening policy making and implementation capacity of the respective governments is how USAID could help in a second-generation round of reforms.

Finally, in terms of countries requiring attention as suggested by the number of areas in which they scored badly, Haiti, Jamaica, and Ecuador, seem to call for priority attention in the efforts for an extended trade area in the Americas.

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[29] See Burki and Perry, **The Long March**, already cited in footnote 1.

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